



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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Order Instituting Rulemaking into the Review  
of the California High Cost Fund B Program

R.06-06-028  
(Filed June 29, 2006)

**REPLY COMMENTS OF  
THE DIVISION OF RATEPAYER ADVOCATES  
ON PHASE II ISSUES**

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Pursuant to Rule 6.2 of the Commission's Rules of Practice and Procedure, and the Ruling by Administrative Law Judge (ALJ) Pulsifer granting modifications to the filing dates for comments on Phase II issues in Rulemaking (R.) 06-06-028,<sup>1</sup> the Division of Ratepayer Advocates (DRA) submits these Reply Comments in response to parties' Opening Comments on the issues identified in the October 5, 2007 Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues (10/5/07 ACR).

**I. EXECUTIVE SUMMARY**

- The Commission should focus first on determining reverse auction parameters such as the definition of basic service and service quality and performance standards.<sup>2</sup>
- Once it has established reverse auction parameters, the Commission should focus next on establishing the applicable area(s) best suited to a pilot auction and on other administrative details related to the pilot project.<sup>3</sup>

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<sup>1</sup> Electronic mail from Peter Casciato, Time Warner Telecom of California, L.P., to the Service List for R.06-06-028, dated October 19 2007, with subject line "Fwd: RE: October 5, 2007 Assigned Commissioner's Scoping and Scheduling Ruling: Request to Unify Filing Dates And Extend the Filing Schedule 4 days."

<sup>2</sup> See, *infra*, Section II.A.

<sup>3</sup> See, *infra*, Section II.B.

- The Commission should utilize focused working groups and workshops to accomplish the above tasks.
- After the Commission has collected data from the pilot project, it should then focus on establishing a fully functioning and viable statewide reverse auction to allocate universal service support from the California High Cost Fund-B (CHCF-B or B Fund).<sup>4</sup>
- None of these tasks requires an update of the cost results from the HAI Model Version 5.3 (HM 5.3), and the results of such an update would not be sufficiently meaningful to justify the substantial amount of effort expended.<sup>5</sup>
- DRA’s proposal to allow monthly basic price cap increases for URF incumbent local exchange carriers (ILECs) of *no more than* \$2.00 a year is consistent with the proposals of SureWest and Verizon, and should be adopted.<sup>6</sup>
- AT&T and DRA agree that, as an interim measure, the Commission should allow AT&T’s basic phone rate (and, DRA proposes, the basic phone rates of Frontier and Verizon) to increase to *no more than* \$18.90.<sup>7</sup> Until the Commission can identify the level of an “affordable” local phone bill, the Commission should only allow increases up to the highest basic residential rate that the Commission has already found to be reasonable.<sup>8</sup>
- Contrary to the suggestions of some parties, the Commission should require annual COLR certification at the “affordability” level yet to be determined.<sup>9</sup>

## II. THE COMMISSION SHOULD FOCUS ON DEVELOPING REVERSE AUCTION PARAMETERS AND A PILOT PROJECT

The numerous ideas and concerns raised in the Opening Comments responding to the 10/5/07 ACR clearly illustrate the complexity of developing a reverse auction and ensuring that it functions effectively. Most parties seem open to attempting a reverse auction mechanism, although some (such as TURN) express concerns about the

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<sup>4</sup> See, *infra*, Section II.A and B.

<sup>5</sup> See, *infra*, Section III.

<sup>6</sup> See, *infra*, Section IV.B.

<sup>7</sup> See, *infra*, Section IV.C.

<sup>8</sup> See, *infra*, Section IV.C and D.

<sup>9</sup> See, *infra*, Section V.

feasibility of doing so. In these Reply Comments, DRA will attempt to build on parties' Opening Comments by presenting constructive suggestions on how best to proceed in developing a statewide reverse auction. In particular, DRA's Reply Comments provide suggestions as to the format and schedule for a series of working groups and workshops that will facilitate the timely implementation of a reverse auction.

The Commission should adopt DRA's recommendations with the goal of formulating and implementing a pilot project through which the reverse auction can be tested in discrete areas with opportunities to work out any difficulties before implementing a statewide reverse auction. Further, DRA recommends that the B Fund be frozen as it is, with the exception of phasing down the fund as outlined in Decision (D.) 07-09-020, until the pilot project is completed. This will provide an incentive for all parties to ensure that development of the reverse auction occurs in a timely manner.

**A. DRA's Recommended Approach to Developing Reverse Auction Parameters**

The parties Opening Comments make it clear that there are several issues that are best addressed through the workshops that the Commission has proposed for developing the reverse auction process, rather than solely through the receipt of high-level Comments.<sup>10</sup> DRA has identified some of the initial issues that the Commission should address through workshops, but with a format that includes technical working groups to increase the efficiency and effectiveness of the workshops.<sup>11</sup>

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<sup>10</sup> See, for example, Verizon Opening Comments at 7, proposing a technical workshop to develop a model Request for Quotes ("RFQ") identifying the supported services a bidder would be required to provide, along with any other requirements for eligibility. (Unless otherwise noted, the "Opening Comments" of a party cited herein refer to the party's comments filed on November 9, 2007.)

<sup>11</sup> DRA does not mean to limit the working-group/workshop process to the topics listed herein, but rather suggests that the Commission use this approach to address topics best explored interactively among participants who may be able to narrow the range of disagreement and to develop superior, integrative solutions that would not be readily achieved through a less-directed (and potentially more adversarial) Comment and Reply Comment process.

## **1. The Commission Should Employ Working Groups and Workshops**

DRA proposes that technical working groups be convened to address specific issues, with clearly defined parameters, and report back to the Commission and interested parties with recommendations, with the goal of defining and implementing a pilot project for the reverse auction process. To maximize the effectiveness of the working groups, DRA recommends that each working group include only one, or at most two, representatives from each interested party. Workshop participants should include various industry sectors, e.g. URF ILECs, wireless providers, cable VOIP providers, as well as consumer advocates. The Commission should urge parties to provide representatives with the experience and ability to consider the technical and business-related aspects of the issues. DRA also recommends that the working groups be free to establish their own schedules and processes for exchanging ideas and developing recommendations, but be given a set period (such as 45 days) to reach as much consensus as possible, and to issue a report with consensus recommendations and any dissenting opinions.

After the working groups have reported their recommendations, the Commission should hold workshops to allow all potentially affected parties to ask questions about the working-group proposals and provide their suggestions and concerns. The Commission should send out notices inviting any provider that holds a Certificate of Public Convenience and Necessity (CPCN), or, in the case of a wireless provider, has registered with the Commission, to participate in the workshops to design the reverse auction parameters, as well advertise those workshops widely in the trade press. This will allow a wider range of input than just those parties currently participating in this proceeding. The Commission also may want to consider allowing participation in the workshops by those who do not have full party status. The workshops could thus take a format similar to a Public Hearing, without necessitating committed participation in the entire proceeding, but allowing the Commission to hear from as many potential bidders and other interested parties as possible.

While the working group/workshop process may superficially sound time-consuming and cumbersome, it is actually more efficient and efficient than multiple rounds of Comments. Additionally, as DRA explained in its Opening Comments, using this process is likely to result in the creation of a more viable and functional design.

## **2. High-Priority Issues That Are Appropriate For Working Groups and Workshops**

Before constructing the pilot project, the Commission will need to determine certain parameters of the reverse auction mechanism. Almost all parties recognize that the success of any auction depends on having enough eligible, well-qualified bidders.<sup>12</sup> Several parties agree that the Commission should give particular attention to specifying the standards that bidders must meet to be eligible for CHCF-B support.<sup>13</sup> As a starting point for addressing these standards, DRA identifies below two areas that would benefit from the use of the working group/workshop format – the definition of basic service and service quality/performance standards.

In the context of the B-Fund, most parties suggest that the definition of basic service needs to be updated.<sup>14</sup> Refining the definition of basic service will not only help to ensure enough bidders to make an auction work, but will also help providers to determine upfront whether they qualify to bid in the auction. DRA proposes that the first step toward re-examining the definition of basic service is to establish a working group consisting of representatives from both ILECs and competing basic service providers, as well as consumer groups and any other interested parties. The Commission should assign

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<sup>12</sup> DRA Opening Comments at 5; TURN Opening Comments at 19; T-Mobile Opening Comments at 3; Cox Opening Comments at 1; CCTA Opening Comments at 4; Time Warner Opening Comments at 4, and; Verizon Opening Comments at 1.

<sup>13</sup> DRA Opening Comments at 8; T-Mobile Opening Comments at 6; Cox Opening Comments at 3 and 6; Verizon Opening Comments at 4; AT&T Opening Comments at 3; Sprint Nextel Opening Comments at 14, and; TURN Comments at 23.

<sup>14</sup> DRA Opening Comments at 33; T-Mobile Opening Comments at 3; Cox Opening Comments at 3; CCTA Opening Comments at 4-5; Time Warner Opening Comments at 8; Verizon Opening Comments at 1-2 and 25-26; AT&T Opening Comments at 2 and 10, and; Sprint Nextel Opening Comments at 8-10 and 29.

to this working group the task of identifying the basic service requirements that should be applicable and the services deemed necessary for today's consumers. To facilitate a successful auction, the Commission should make clear that it seeks a competitively and technologically neutral definition of basic service that will allow as many providers as possible to compete for B-Fund support, while at the same time ensuring that all consumers have access to sufficiently reliable and affordable service options.<sup>15</sup>

Using the working group/workshop format for this issue could provide the Commission with crucial information regarding possible ways that the proposed definition of basic service can be met. Participants may have valuable information about alternative ways to meet the definition of basic service particular to their own technology, while still meeting the needs of consumers needing basic residential service. For example, it might be possible that cable providers of VOIP services could offer "stand alone" basic service while blocking broadband access for those consumers who want only basic residential service. As another example, suppose that the working group recommends that the ability to receive inbound calls at an affordable price be considered a defining characteristic of basic service. To meet this requirement, wireless providers might propose that they could include a certain number of inbound local calls for "free" as part of a flat-rated wireless service package. A working group/workshop environment will allow the Commission and interested parties to explore both the merits of alternatives that can enable intermodal providers to fulfill consumers' expectations regarding basic service and the willingness of intermodal providers to provide those alternatives.

On a closely related issue, many parties note the need for very explicit service quality and performance standards so that a service provider knows exactly what is

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<sup>15</sup> As DRA has previously discussed, in order to assure affordable local phone service, the Commission must first define what affordability is. Both DRA and TURN continue to strongly recommend that the Commission order a modified version of the Field Research Affordability study to assist in such a determination. *See* DRA Further Comments, 4/27/07, at 8 and 52; TURN Opening Comments at 15. Further, in order to ensure reliable service, the Commission should convene the working groups and workshops regarding service quality and performance standards recommended in these Reply Comments.



expected before entering into a bidding process.<sup>16</sup> DRA recommends that the Commission convene working groups to consider service quality requirements and performance standards for winning bidders. While some parties claim that no extra service quality standards are necessary beyond those already in place,<sup>17</sup> DRA believes this issue should be examined by working groups, rather than decided on the basis of high-level comments. Further, DRA recommends that service quality and performance standards be symmetrical for all participants seeking a B-Fund subsidy. Any provider that cannot meet Commission-established service quality or performance standards should not be allowed to bid.<sup>18</sup>

#### **B. DRA's Recommended Approach to Developing a Pilot Project**

Once the Commission has determined initial parameters such as the basic-service definition and service-quality standards, it should move forward with establishing a pilot project. Several parties consider a pilot project to be an essential initial approach,<sup>19</sup> especially since establishing a reverse auction for high-cost areas is such a groundbreaking decision. A pilot project will offer crucial information as to how to proceed with a statewide auction and offer an opportunity to fix any initial problems in the auction structure.

TURN suggests selecting areas large enough to provide for economies of scale and enable a realistic simulation, and mentions the Truckee-Donner area as one possibility.<sup>20</sup>

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<sup>16</sup> DRA Opening Comments at 9; TURN Opening Comments at 23; Sprint Nextel Opening Comments at 14; AT&T Opening Comments at 3 and 6; and Verizon Opening Comments at 7.

<sup>17</sup> Cox Opening Comments at 6; AT&T Opening Comments at 6; and Sprint Nextel Opening Comments at 12.

<sup>18</sup> Additionally, DRA strongly disagrees with AT&T's recommendation that if service quality and performance standards prevent a particular technology from participating, the Commission should consider whether the standards are necessary. *See* AT&T Opening Comments at 6. That notion is completely contrary to the purpose of such standards, and would harm consumers if adopted.

<sup>19</sup> DRA Opening Comments at 12; TURN Opening Comments at 38-39; Verizon Opening Comments at 15; AT&T Opening Comments at 13; and Sprint Nextel Opening Comments at 16.

<sup>20</sup> TURN Opening Comments at 38-39.

Sprint proposes three different areas: (1) one area with only an ILEC provider; 2) one area with an ILEC and a cable provider; and 3) one area with an ILEC, a cable, and multiple wireless providers.<sup>21</sup> AT&T recommends selecting one or more CBGs with the highest support level and estimated costs.<sup>22</sup>

Each of these suggestions may have some viability, but DRA recommends that the auction area(s) be explored further through working groups and workshops.<sup>23</sup> The Commission should specifically solicit any current or potential service providers that may be interested in placing a bid to participate in the process as they may have relevant information regarding the best areas to carry out the pilot project. After participants have tentatively identified an area or areas for the pilot project, the Commission may wish to solicit comments on the desirability of those areas, as suggested by AT&T.<sup>24</sup>

Selecting the geographic areas for the pilot project is only one of the many details remaining to be addressed. Another critical “detail” is the actual format of the auction. Some parties have suggested that the Commission permit contingent bids on “packages” of auction areas.<sup>25</sup> To provide as accurate a view as possible on how such a reverse auction would function at the statewide level, the areas selected for the pilot would have

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<sup>21</sup> Sprint Nextel Opening Comments at 16. DRA questions the benefit of testing an auction in an area with only an ILEC provider. DRA continues to recommend that in such an area, where an auction is unlikely to work because of lack of bidders, an ILEC that desires to continue receiving the subsidy should make a cost showing to the Commission demonstrating the necessity for the subsidy. *See* DRA Opening Comments at 34. However, even if the ILEC makes an adequate cost showing, DRA recommends that the Commission cap the amount of support at the current level, or even at a reduced level as supported by D.07-09-020, per Sprint Nextel’s suggestion. *See* Sprint Nextel Opening Comments at 18.

<sup>22</sup> AT&T Opening Comments at 13.

<sup>23</sup> DRA recommended that at least two areas should be selected: one area that is currently designated as high cost but is relatively densely populated, and the other area in a more remote location. DRA also suggested that the Commission might wish to do a third pilot project in an area that has a limited number of potential bidders. *See* DRA Opening Comments at 12. DRA maintains these recommendations, but advises the Commission to explore all the possibilities through workshops to determine the best area or areas for a pilot project.

<sup>24</sup> AT&T Opening Comments at 13.

<sup>25</sup> Verizon Opening Comments at 6; AT&T Opening Comments at 11; and TURN Opening Comments at 33.

to be large enough for service providers to bid on multiple contiguous Census Block Groups (CBGs). The Commission should solicit input from working group and workshop participants on this approach, and on the desirability of varying the auction format across the different pilot areas. In addition to the auction “format,” the Commission also will need to select an administrator for the pilot project and solicit the appropriate software to conduct and monitor the pilot project.

**C. DRA’s Recommended Approach to Developing a Statewide Auction**

Once all of these steps have been taken and the pilot project has been implemented, there should be a period to review the empirical data about how the pilot project functioned, including: the number and type of bidders; the initial, interim and winning bids; and other auction operational results. DRA recommends that the Commission make such data public to the maximum extent possible, and that it solicit comments about how to proceed in any statewide implementation based on the pilot data.

**III. NO PARTY HAS PROVIDED A PLAUSIBLE PLAN FOR “UPDATING” HM 5.3 OR A GOOD REASON FOR DEVELOPING ONE.**

The substantial majority of Commentors (wisely) advise against any attempt to update HM 5.3.<sup>26</sup> As DRA explained (and other parties agree), any effort to “update” HM 5.3 would require a substantial proceeding, will be hugely contentious and will lead in the wrong direction.<sup>27</sup> Most non-ILEC parties also emphasize that, should the Commission use HM 5.3 at all, it will need to incorporate a cap to avoid the risk of

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<sup>26</sup> AT&T Opening Comments at 19; CCTA Opening Comments at 2; Cox Opening Comments at 2 and 5; DRA Opening Comments at 20; Sprint Nextel Opening Comments at 23; Time Warner Opening Comments at 5-6; T-Mobile Opening Comments at 9-11; and TURN Opening Comments at 43. Frontier offers no opinion on the use of HM 5.3 other than that the “data and input included in the model be representative of all the California ILECs.” Given that no HM 5.3 customer input data or other model inputs yet exist for ILECs other than AT&T and Verizon, implementing this suggestion would be like starting an entirely new cost proceeding for the other ILECs.

<sup>27</sup> *Ibid.* Moreover, as HM 5.3 does not model a world with intermodal competition, it cannot help achieve the Commission’s goals of a uniform and competitively neutral regulatory framework.

reversing the Commission's good work in this proceeding to date and reestablishing substantially inflated subsidies.<sup>28</sup> Using the total cost from HM 5.3 without some cap will harm both competition and customers. As long as the ILECs are subsidized for the full cost of replacing their old, inefficient networks, they will have less incentive to upgrade to a more modern and efficient network (which will also bring new service options to rural areas). More efficient potential competitors will also shy away from entering those areas while the ILECs maintain the competitive advantage of a hefty subsidy.

Although parties strongly discourage updates to HM 5.3, some, unenthusiastically, suggest that HM 5.3 might still have limited applicability as a means of identifying high cost areas or for setting maximum auction bids.<sup>29</sup> Attempting to implement an out-of-context, partial use of HM 5.3 would be complex and is likely to fail. The Commission has existing identified high-cost subsidy areas and has just set what would be the maximum auction bid in those areas – *i.e.*, the remaining subsidy at the end of the D.07-09-020 phase down. Trying to replace the existing subsidy-eligible CBGs with a new set of CBGs from HM 5.3 begs the question of how the Commission would determine the subsidy amount to be paid in the new areas in the gap before an auction can be implemented. That would require yet another proceeding to reset the subsidy fund to cover those locations and would likely require updating HM 5.3 (only to obtain costs for an obsolete, ILEC-only network) as well. As Time Warner notes in rebuttal to its own suggested possible use of HM 5.3, it makes more sense to postpone *any* use of HM 5.3

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<sup>28</sup> DRA Opening Comments at 15-19; Sprint Nextel Opening Comments at 24; T-Mobile Opening Comments at 10-11; Time Warner Opening Comments at 7; and TURN Opening Comments at 43-44.

<sup>29</sup> Time Warner Opening Comments at 5; and T-Mobile Opening Comments at 4 and 9-10. Although T-Mobile suggests that HM 5.3 might have some use in determining the forward-looking cost of ILEC networks, it also indicates that it is “unclear how such data could be used” or if it could be potentially useful at all because using HM 5.3 would be far more difficult and complex than other available options.

until after assessing the result of an auction process as it may prove entirely unnecessary or a more desirable option might emerge.<sup>30</sup>

Time Warner does a good job of summarizing why HM 5.3 data (either updated or as is) is of limited relevance (at best).<sup>31</sup> As Time Warner explains, the cost of rebuilding the non-video network that the ILECs have in the ground in most high-cost areas of California will never again be a relevant forward-looking cost (which is what HM 5.3 is designed to produce). Instead, the forward-looking cost question that an ILEC currently faces in a high-cost area is whether its net revenue will be greater if it 1) upgrades its network to the current all-media network design, which would reduce its long-run costs relative to what is modeled in HM 5.3 and also generate substantial new revenue opportunities from video and other advanced services, or 2) limits its costs to the level needed to maintain its long-established (but obsolete) voice and data network given the limited services and bundles that network is able to offer.<sup>32</sup>

Time Warner's analysis provides an additional basis on which the Commission might limit any subsidy based on the adopted HM 5.3 results to only operations and maintenance costs. Operation and maintenance costs are the only component of cost that HM 5.3 generates that is relevant to the ILEC's current network cost structure in high-cost areas).<sup>33</sup> Should the ILEC decide to maintain its old network infrastructure, its forward-looking costs will primarily be the cost of maintaining its obsolete network. Should it determine to replace that network, the new investment will not resemble what HM 5.3 models and the decision will be driven by services other than basic voice.

AT&T and TURN argue that it is not appropriate to use HM 5.3 operations and maintenance costs as an interim COLR subsidy cap because the ILEC will eventually

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<sup>30</sup> Time Warner Opening Comments at 6-7.

<sup>31</sup> Time Warner Opening Comments at 5-7.

<sup>32</sup> Time Warner Opening Comments at 6-7.

<sup>33</sup> DRA Opening Comments at 19-20.

need to replace its old plant.<sup>34</sup> However, that concern is not relevant to a determination of the level of an *interim* subsidy cap. A permanent subsidy mechanism will *ultimately* need to consider the Carrier of Last Resort's (COLR's) total cost, including investment, in some manner. If the Commission implements an auction, the competing carriers themselves will determine how much of their investment is relevant to basic voice service and the period over which they recover that investment when they place their bids. In contrast, as discussed above, investments derived from HM 5.3 will necessarily overstate the required subsidy because they are investments for an obsolete network (one that was, most part, long ago funded by ratepayers). Thus, for an interim CHCF-B funding cap, the operations and maintenance costs from HM 5.3 is a more accurate proxy for the COLR's actual going-forward cost than is the total cost from that model.

Verizon is the only party that actively advocates updating HM 5.3 or provides specific suggestions for doing so.<sup>35</sup> Even Verizon, however, admits that cost proxy models like HM 5.3 “are inherently unreliable and inaccurate as a mechanism to determine absolute cost levels” and that Verizon itself has previously “criticized HM 5.3 extensively...for producing cost results that were erroneously low.”<sup>36</sup> Verizon's omits that it also complained that HM 5.3 produces costs that may be *too high specifically in the low-density, high-cost areas* that would be relevant in this proceeding.<sup>37</sup> Hence, *no* party claims that HM 5.3, with or without updates, will produce reasonably accurate or

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<sup>34</sup> AT&T Opening Comments at 20-21 and TURN Opening Comments at 45.

<sup>35</sup> Verizon Opening Comments at 19-22. Time Warner suggests that HM 5.3 might have limited use, if updated, for determining ILEC subsidy in an area in which no competitive bidders participate in an auction. Time Warner Opening Comments at 5. However, it provides no suggestion regarding how such updates might be done or what they might include. Moreover, Time Warner concludes that the Commission should not begin to consider updates to HM 5.3 unless and until an auction has failed and the Commission has assessed other options in the light of that result. Time Warner Opening Comments at 5-7.

<sup>36</sup> Verizon Opening Comments at 18.

<sup>37</sup> See DRA Opening Comments at 17.

meaningful estimates of the subsidy needed to support service in California's high-cost areas.

The motivation for Verizon's unique stance is not mysterious. As DRA already explained, using HM 5.3 to calculate subsidies at the CBG level would increase Verizon's subsidy tremendously. For example, even with a \$36 cap, simply moving to the existing HM 5.3 results would result in an \$85 million subsidy for Verizon, about 70% more than the \$40 million it received prior to D.07-09-020 and three-times the \$27 million subsidy that will be in place for Verizon after the D.07-09-020 subsidy phase down.<sup>38</sup> Verizon would have an opportunity to try doubling even that \$85 million subsidy if the Commission allows Verizon to propose updates to the adopted HM 5.3. As opposed to the \$13.94 figure that the Commission adopted for basic loops using HM 5.3, Verizon's estimate was that loops should cost \$33.19.<sup>39</sup> Verizon undoubtedly has modifications ready to roll that would inflate the HM 5.3 outputs well over 100 percent, back to near or above the \$33.19 level that Verizon advocated in its UNE case (and that the Commission rejected). The Commission should not be fooled by Verizon's proposed "limited number of platform changes" for HM 5.3.<sup>40</sup> Verizon's list includes not only generating an all-new input database (the most controversial component of the model) but also redoing the bulk of the most contentious inputs such as fill factors, plant structure inputs, structure sharing, equipment cost and plant sharing assumptions.<sup>41</sup> The Commission need only skim the table of contents from its prior UNE cost decisions to confirm that those were among the most hotly contested modeling inputs and assumptions in prior UNE cases. Worse, Verizon proposes that all modeling inputs would need to be standardized for all ILECs in California.<sup>42</sup> Given the substantial

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<sup>38</sup> DRA Opening Comments at 17 and Attachment 1.

<sup>39</sup> D.06-03-025 at 2 and 4.

<sup>40</sup> Verizon Opening Comments at 20.

<sup>41</sup> *Id.*

<sup>42</sup> Verizon Opening Comments at 19.

differences in ILEC contract arrangements and thus input price formats, it is far from certain that such a reconciliation of inputs would even be possible.

**IV. THE COMMISSION SHOULD CONFIRM AN INTERIM STATEWIDE MAXIMUM RATE OF \$18.90 FOR PRIMARY RESIDENTIAL BASIC EXCHANGE SERVICE, AND LIMIT ANNUAL RATE INCREASES FOR URF ILECS NOW BELOW THAT CAP TO NO MORE THAN \$2.00**

In its Opening Comments, DRA proposes that, while the Commission is developing the record necessary to identify what an affordable local phone bill is for most Californians,<sup>43</sup> the Commission should adopt a transitional plan for URF ILECs that allows their basic residential rates to increase up to a level that does not exceed \$18.90. This amount would allow rate increases up to the highest tariffed rate among the URF ILECs, the highest rate for local phone service that the Commission has thus far identified as being reasonable.<sup>44</sup> DRA also proposes that, to minimize customer rate shock, the Commission should only allow monthly rates to increase to the level of \$18.90 by an absolute maximum of two dollars per year.<sup>45</sup>

**A. The Commission Should Ignore Proposals To Eliminate Transitional Price Caps**

In D.07-09-020, the Commission unambiguously concluded that the URF ILECs in California would continue to have price caps on their stand-alone basic residential service offering for a “transition” period prior to full pricing flexibility.<sup>46</sup> In Opening

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<sup>43</sup> DRA agrees with TURN that it is most definitely premature for the Commission to adopt the “maximum” rate for basic phone service that can be considered “affordable” for the purposes of deciding the highest basic rate cap before full pricing flexibility is allowed. TURN Opening Comments at 45-46.

<sup>44</sup> DRA Opening Comments at 24-28. DRA also recommends that the Commission ensure that no service provider be able to charge rates in any part of its service territory that are higher than 150% of the lowest rate that service provider charges in any other pricing zone for the same service. *Id.* at 24.

<sup>45</sup> DRA Opening Comments at 28-30. As a practical matter, the recommendation of a maximum annual increase of up to two dollars only applies to AT&T’s rates because the other URF ILECs are already within two dollars of \$18.90.

<sup>46</sup> D.07-09-020 at 96.



Comments, however, some parties attempt to reargue this issue and promote the removal of all basic rate caps for the ILECs as soon as statutorily authorized.<sup>47</sup> In supporting its claim that “there should be an immediate and complete lifting of the caps on ILECs’ basic service rate,” Sprint/Nextel goes so far as to submit a Declaration on why the Commission “need not fear sudden and extraordinary increases in ILEC retail rates” if price caps are lifted.<sup>48</sup>

Having already determined that transitional rate caps would be implemented for the URF ILECs after 1/1/09, the Commission should ignore all arguments to the contrary as being beyond the scope of this phase. Such a discussion distracts from the stated goals of Phase II which, with regard to ILEC basic rates, are to adopt the specific increase levels and the timeline for those increases.<sup>49</sup> Furthermore, the appropriate vehicle for these arguments is either an Application for Rehearing or a Petition to Modify a Commission decision under Commission Rules 16.1 and 16.4, respectively.

Finally, as a substantive matter, DRA also notes that California’s application of price caps on basic phone rates continues to be in step with the rest of the country. In Opening Comments, TURN references a 2007 NRRI report regarding phone regulation in other states, and observes that “the overwhelming majority of states place some type of cap on basic rates.”<sup>50</sup> Thus, the Commission should dismiss arguments about whether price caps should be maintained in the near term, and should proceed, as intended, to focus on the details of the transitional rate caps that should be applied to each URF ILEC.

#### **B. Two URF ILECs Support Price Cap Increases Of Approximately \$2.00 A Year**

DRA explains in its Opening Comments that customers of stand-alone basic residential service should not, as a result of this regulatory transition, be faced with a

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<sup>47</sup> See, e.g., Sprint Nextel Opening Comments at 26-27; Verizon Opening Comments at 22-23.

<sup>48</sup> Sprint Nextel Opening Comments at 26-27 and Exhibit 1 (Declaration of Chris Frentrup).

<sup>49</sup> D.07-09-020 at 97; 10/5/07 ACR at 6-7.

<sup>50</sup> TURN Opening Comments at 48.

monthly rate increase that is higher than \$2.00 per year, at the most.<sup>51</sup> There are a surprising number of commonalities between DRA’s proposed maximum increase of \$2.00 per year and the proposals of other parties. SureWest, for example, explicitly recommends total annual increases to monthly rates of between one and two dollars, with Commission re-evaluation of the transition process after a period of three to five years.<sup>52</sup> While Verizon recommends annual price cap increases and a “target” or maximum price cap that may vary by ILEC, Verizon’s proposed formula for its own price caps amounts to an increase of \$5.92 over three years, or less than \$2.00 a year.<sup>53</sup>

TURN provides important evidence that a “plurality” of states allow no basic service rate increases, and that those that do primarily allow very gradual increases such as those indexed for inflation.<sup>54</sup> Using a comparison of basic rate regulation across the country, TURN provides compelling support for its conclusion that, “where rate changes are permitted at all, principles of gradualism apply.”<sup>55</sup> Thus, while TURN adamantly opposes any rate cap increases, TURN does note that, to the extent that the Commission allows such increases, there should be no more than a 10% increase in rates over a 5-year period.<sup>56</sup>

In stark contrast, Frontier advocates allowing monthly increases of up to \$4 per year,<sup>57</sup> while AT&T appears to seek an increase of about \$5.16 each year for a two-year

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<sup>51</sup> DRA Opening Comments at 28-30.

<sup>52</sup> SureWest Opening Comments at 2. DRA notes that this recommendation is premised on the assumption that \$36.00 will be the maximum price cap prior to full pricing flexibility, an assumption that DRA does not support, and that DRA does not believe is supported by the record, as discussed in Section IV.D, *infra*.

<sup>53</sup> Verizon Opening Comments at 23. As with other parties Verizon objects to the use of any price caps on principle. Verizon Opening Comments at 22. DRA notes that it does not agree with Verizon’s formula as it applies to AT&T, which would result in a rate cap increase of \$20.34 over three years. *Id.* at 23-24.

<sup>54</sup> TURN Opening Comments at 47.

<sup>55</sup> TURN Opening Comments at 48.

<sup>56</sup> TURN Opening Comments at 49.

<sup>57</sup> Frontier Opening Comments at 5.

period.<sup>58</sup> This approach would be inconsistent with both the Commission's own concerns about consumer rate shock<sup>59</sup> and the gradualism identified by TURN. Based on AT&T's current charges of \$10.69, for example, such a rate change would be an increase of 48.3% the first year, and 96.5% over the two years AT&T suggests.<sup>60</sup>

In sum, DRA's proposal of a maximum annual increase in monthly rates of up to \$2.00, at the most, is consistent with the proposals of two URF ILECs. It is also considerably higher than the expected inflation rate, which is the amount that most states appear to sanction, if they allow any basic rate increase at all.<sup>61</sup> DRA also agrees with TURN that any increases in basic rate caps that are being considered in this phase of the proceeding should not begin until after January 1, 2009.<sup>62</sup>

**C. As An Interim Measure, Maximum Rate Caps Should Not Exceed \$18.90**

With regard to the maximum rate caps that should be applied in the near term, DRA and AT&T appear to agree in principle that AT&T's rates should be allowed to increase to, in AT&T's words, "the rates charged by other ILECs in California."<sup>63</sup> DRA agrees with TURN that it would be premature for the Commission to adopt a "maximum rate cap" without a better understanding of the phone bill amounts that would be truly affordable to Californians.<sup>64</sup> Nevertheless, DRA proposes that, as an interim measure while the Commission conducts further inquiries, the Commission could adopt a

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<sup>58</sup> AT&T Opening Comments at 22. As discussed, *infra*, AT&T's proposal appears to differ somewhat from DRA's proposal in that AT&T seeks additional rate increases above the difference between its basic rate and those of the other URF ILECs. *See, infra*, Section IV.C.

<sup>59</sup> D.07-09-020 at 96.

<sup>60</sup> This calculation is based on the current rate identified by AT&T in its Opening Comments (AT&T Opening Comments at 22), and does not include the Consumer Price Index-U inflation adjustment authorized by the Commission beginning on 1/1/08 (D.07-09-020 at 95).

<sup>61</sup> TURN Opening Comments at 47.

<sup>62</sup> TURN Opening Comments at 46.

<sup>63</sup> AT&T Opening Comments at 22.

<sup>64</sup> TURN Opening Comments at 45-46; *see also* DRA Opening Comments at 24-28.

transition schedule based on the principle that no basic rate should exceed \$18.90, at the most, which is the highest basic rate that the Commission has thus far determined to be fair and reasonable.<sup>65</sup> (DRA also recommends an accompanying company-specific rate cap that would prevent a service provider from charging rates, in any part of its service territory, that are higher than 150% of the lowest rate that service provider charges in any other pricing zone, for the same service.<sup>66</sup>)

AT&T argues that its proposal “would simply bring AT&T California’s basic rate plus EUCL [the End User Common Line charge] in line with the rates paid by customers of other ILECs *today*. AT&T California’s maximum rate would conclusively be reasonable.”<sup>67</sup> For the reasons discussed in DRA’s Opening Comments, DRA believes that phasing-in annual rate adjustments of no more than \$2.00, up to an interim maximum basic rate cap of \$18.90, would allow increases in AT&T’s low basic rate while limiting the threat to the Commission’s goal of maintaining universal service,<sup>68</sup> and DRA’s concerns about rate shock impacts on customers.

While DRA and AT&T agree on a near-term maximum basic rate in principle, DRA must note that AT&T is actually proposing a rate increase of more than merely \$8.21, the difference between AT&T’s rate and SureWest’s basic rates which are currently \$10.69 and \$18.90, respectively.<sup>69</sup> Instead, AT&T proposes that its basic rate plus its EUCL,<sup>70</sup> a federal-jurisdictional charge, rise as high as the basic rates plus the EUCLs of the other URF ILECs.<sup>71</sup> Because the EUCL charge is \$4.39 for AT&T’s

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<sup>65</sup> See DRA Opening Comments at 24 (note 35) and D.06-08-030 at 156-157.

<sup>66</sup> DRA Opening Comments at 24.

<sup>67</sup> AT&T Opening Comments at 22.

<sup>68</sup> DRA Opening Comments at 25-30.

<sup>69</sup> Based on the current rates provided in AT&T’s Opening Comments at 22.

<sup>70</sup> Based on current rates, this amount is \$15.08, or \$10.69 plus a \$4.39 EUCL. AT&T Opening Comments at 22.

<sup>71</sup> Using SureWest’s basic rate, which is the highest, the “total” amount as defined by AT&T is currently \$25.40, or \$18.90 plus a \$6.50 EUCL. AT&T Opening Comments at 22.

customers, while the EUCL charge is \$6.50 for the customers of the other URF ILECs, AT&T is actually asking for a rate increase of up to \$10.32 (or an additional \$2.11 to reflect the difference in EUCL charges).<sup>72</sup> In effect, AT&T's proposal attempts to make up the difference between its EUCL and those of the other URF ILECs, despite the fact that the higher EUCLs reflect recovery of federal jurisdictional costs and do not in any way increase the intrastate revenues of the other URF ILECs. AT&T offers no explanation for why it would be appropriate for AT&T to charge its customers an additional amount of \$2.11 that AT&T can then retain as intrastate revenue, merely because its interstate EUCL is lower than those of the other URF ILECs. DRA thus urges the Commission to disregard AT&T's baseless request to make up the difference between the EUCL charges through intrastate rate increases, and to instead use the tariffed intrastate basic rates, and SureWest's \$18.90 in particular, to set the interim maximum rate cap for the transition period.

**D. The Commission Has Not Adopted \$36.00 as the Maximum Affordable Basic Rate Cap**

Despite the inferences that could be drawn from the Opening Comments of some parties, the Commission has *not* determined that \$36.00 is the "affordable" level at which basic phone rates should be capped.<sup>73</sup> The Commission clearly stated in D.07-09-020 that \$36.00 will be the high-cost benchmark for the purposes of identifying CBGs as high cost and calculating the amount B Fund support, and not a cap on retail rates.<sup>74</sup>

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<sup>72</sup> To put it another way, \$10.32 is the requested increase resulting from adjusting AT&T's current "total" of \$15.08 up to SureWest's current "total" of \$25.40. AT&T Opening Comments at 22.

<sup>73</sup> Verizon Opening Comments at 23. SureWest states that it "supports the principle identified in D.07-09-020 that the potential for rate shock exists if basic rates are permitted to rise immediately to the \$36 benchmark. *See* D.07-09-020 September 6, 2007), *mimeo*, p. 77." SureWest Opening Comments at 2. DRA notes that the citation to D.07-09-020 references the Commission's discussion of phasing in the *high-cost benchmark*, rather than of *price cap increases*, which may have caused confusion.

<sup>74</sup> In its Response to TURN's 10/9/07 Application for Rehearing of D.07-09-020, DRA has urged the Commission to clarify D.07-09-020 by modifying the Ordering Paragraphs of the decision to reflect the intent clearly expressed in the text of the decision. Response of the Division of Ratepayer Advocates to TURN's Application for Rehearing of D.07-09-020 (October 24, 2007). TURN's Application for Rehearing is still pending.

While the \$36 benchmark will serve as the basis for identifying and limiting the residential lines eligible for B-Fund support, the revised benchmark is *not* intended to serve as the basis for setting basic rate cap levels. As explained below, [the Commission] shall separately determine suitable transition increases in the basic service rate caps for each respective ILEC in the next phase of this proceeding to avoid any risk of rate shock.<sup>75</sup>

Hence the Commission's invitation in the 10/5/07 ACR to parties in Phase II that they comment on what the "maximum level" of increases to the basic rates of URF ILECs should be.<sup>76</sup> The Commission should therefore disregard any comments of parties that seem to rely on the erroneous assumption that \$36.00 is the *de facto* basic rate cap.

**V. A CERTIFICATION PROCESS TO QUALIFY FOR B-FUND SUPPORT IS ABSOLUTELY NECESSARY**

AT&T contends that there is no need for recipients of subsidies from the CHCF-B to certify that their retail price for primary residential basic service is at or below the Commission-established cap because those basic rates will be tariffed.<sup>77</sup> Although AT&T accurately describes *today's* regulatory environment, the Commission is considering the expansion of eligibility for B-Fund support to intermodal providers that may not be subject to either this Commission's tariffing rules or those embodied in the Public Utilities Code. Therefore, the Commission should condition eligibility for subsidies on the service provider's voluntary acceptance of a certification requirement. Tying support to a voluntary acceptance of certification not only avoids possible jurisdictional issues, it also provides a clean, clear way for the Commission to verify that recipients of B-Fund subsidies are in fact providing affordable retail service in designated high-cost areas.

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<sup>75</sup> D.07-09-020 at 6 (emphasis in original).

<sup>76</sup> 10/5/07 ACR at 7.

<sup>77</sup> AT&T Opening Comments at 23.

DRA emphasizes that recipients of B-Fund subsidies should be required to certify that their retail prices are at or below the Commission-established *affordability rate* (the rate level to be set in this phase of the proceeding), and not those prices that are at or below the \$36 benchmark rate.<sup>78</sup> As discussed in the context of the URF ILEC price cap increases, the Commission has not yet identified the appropriate rate that should be considered “affordable.”<sup>79</sup> After the Commission has established an affordability rate, it would make little sense to provide subsidies to COLRs that charge *more* than that rate.

Finally, DRA understands D.07-09-020 to hold that any COLR basic rates above the affordability rate would *disqualify* that COLR from receiving money for the area in question.<sup>80</sup> Thus, Verizon errs in assuming that “COLR price increases above the benchmark rate in high cost areas will reduce the COLR’s CHCF-B funding on a dollar for dollar basis.”<sup>81</sup>

## VI. CONCLUSION

The Commission’s next steps in Phase II of this proceeding should be to: (1) implement working groups/workshops to define the parameters of a reverse auction, such as the services and service quality that a winning bidder must provide; (2) initiate a process for gathering the data necessary to determine the “affordability rate” for basic phone service in California, such as by authorizing a Field Research Affordability Study; and (3) consider allowing AT&T’s monthly basic residential rate to increase by *no more than* \$2.00 per year, to a basic rate of *no higher than* \$18.90.

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<sup>78</sup> SureWest, for example, appears to assume that the COLR rate will be the same as the high-cost benchmark rate. SureWest Opening Comments at 2-3. During the transitional period of price cap increases for the URF ILECs, of course, the URF ILECs should be held to the price cap limitations adopted by the Commission. During that time period, the COLR price cap would presumably apply only to non-URF-ILEC COLRs.

<sup>79</sup> D.07-09-020 at 51-52 (“Once the rate cap has increased to an appropriate level (to be determined in [Phase II] of the proceeding, we shall discontinue basic rate restrictions and authorize full pricing flexibility for basic rates.”)

<sup>80</sup> D.07-09-020 at 113.

<sup>81</sup> Verizon Opening Comments at 24.

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/s/ NATALIE D. WALES

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November 28, 2007



**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of “**REPLY COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON PHASE II ISSUES**” in **R.06-06-028** by using the following service:

[ **X** ] **E-Mail Service:** sending the entire document as an attachment to an e-mail message to all known parties of record to this proceeding who provided electronic mail addresses.

[   ] **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on the 28<sup>th</sup> day of November, 2007 at San Francisco, California.

/s/ HALINA MARCINKOWSKI

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Halina Marcinkowski

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